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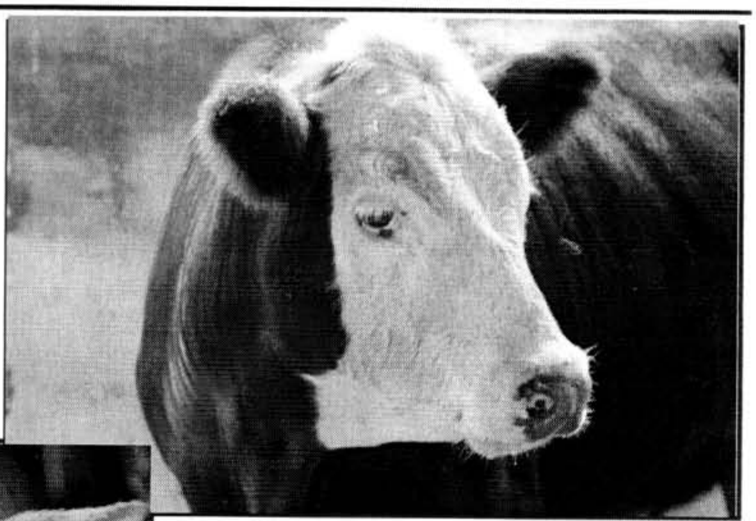
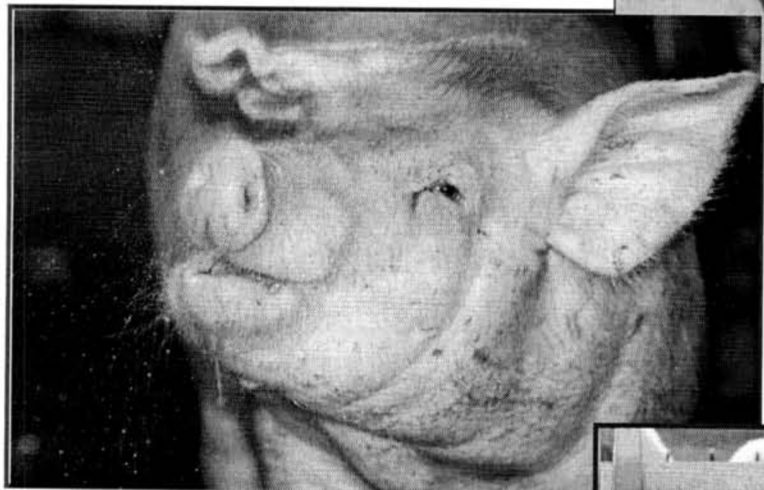
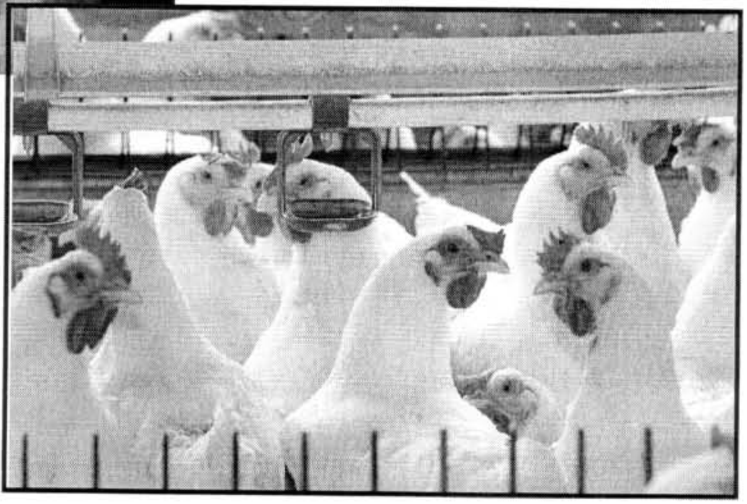
Assessment of the Cattle, Hog, and Poultry Industries

2005 Report







Assessment of the Cattle, Hog, and Poultry Industries

FY 2005 Report

United States Department of Agriculture
Grain Inspection, Packers and Stockyards Administration

March 2006

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List of Acronyms and Abbreviations

AMS	Agricultural Marketing Service
APHIS	Animal and Plant Health Inspection Service
ASTM	American Society for Testing and Materials
BSE	Bovine Spongiform Encephalopathy
cwt	Hundredweight (100 pounds)
DOC	U.S. Department of Commerce
DOJ	U.S. Department of Justice
ERS	Economic Research Service
FATUS	Foreign Agricultural Trade of the United States
FY	Fiscal Year
GIPSA	Grain Inspection, Packers and Stockyards Administration
HPAI	Highly Pathogenic Avian Influenza
HHI	Herfindahl-Hirschman Index
ITC	U.S. International Trade Commission
LPAI	Low Pathogenic Avian Influenza
NA	Not Available
NAIS	National Animal Identification System
NPPC	National Pork Producers Council
NASS	National Agricultural Statistics Service
NCWM	National Conference on Weights and Measures
NIST	National Institute of Standards and Technology
P&S Act	Packers and Stockyards Act
P&SP	Packers and Stockyards Programs
U.S.	United States
USDA	United States Department of Agriculture

Executive Summary

This report has been prepared in response to a requirement in the Grain Standards and Warehouse Improvement Act of 2000 (Pub. L. No. 106-472), enacted on November 9, 2000. Specifically, the Grain Standards and Warehouse Improvement Act of 2000 states:

> [n]ot later than March 1 of each year, the Secretary [of Agriculture] shall submit to Congress and make publicly available a report that—
>
> (1) assesses the general economic state of the cattle and hog industries;
>
> (2) describes the changing business practices in those industries; and
>
> (3) identifies market operations or activities in those industries that appear to raise concerns under this [Packers and Stockyards] Act.

The Secretary of Agriculture is responsible for administering the Packers and Stockyards Act (P&S Act) and delegated that responsibility, through the Under Secretary for Marketing and Regulatory Programs, to the Administrator of the Grain Inspection, Packers and Stockyards Administration (GIPSA). The Packers and Stockyards Program (P&SP), part of GIPSA, administers and enforces the P&S Act and monitors competitive, financial, and trade practices in the livestock, meatpacking, and poultry industries.

This is GIPSA's fifth report to Congress on the general economic state of the cattle and hog industries, changing business practices in those industries, and activities that appear to raise concerns under the P&S Act. This report also includes responses by P&SP to apparent concerns under the P&S Act. The report covers events and data available as of September 30, 2005, the close of the Government's fiscal year (FY).[1]

Trade issues and cyclically tight cattle supplies shaped FY 2005 in the U.S. cattle industry. For most of the year the hog industry benefited from high hog prices, strong domestic and export demand, and low feed prices. In May 2005, signs of weakening domestic demand became apparent, and producers' prices began to decline. In the poultry industry, despite an increase in production in FY 2005, the combination of strong domestic demand and an increase in exports limited downward pressure on broiler prices.

In FY 2005, changes in technology prompted changing business practices in the cattle industry. There was negligible market movement and limited reaction to the additional case of BSE in the U.S. In the hog industry, changing business practices related to swine marketing contracts, carcass evaluation device standards, a countervailing duty on Canadian live swine, and trends toward deeper discounts on heavy hogs. In the poultry industry there were several changes in business practices in FY 2005, including those related to Hurricanes Katrina and Rita.

Market operations or activities that appear to raise concerns under the P&S Act include adequately bonding regulated entities, transparency in the poultry industry, federal litigation in the poultry industry, and livestock, meat, and poultry carcass evalution devices and/or systems. The report identifies the applicability of the P&S Act to these concerns and GIPSA's planned response.

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[1] Fiscal Year 2005: October 1, 2004 – September 30, 2005

Section 1: Cattle Industry

General Economic State of the Cattle Industry

Trade issues and cyclically tight cattle supplies shaped FY 2005 in the U.S. cattle industry. Through September 2005, significant Asian export markets remained closed to U.S. beef. In June 2005, USDA announced a second positive U.S. case of BSE and additional international trading partners immediately imposed bans on U.S. beef and live cattle.[2] Between January and June 2005, however, the U.S. exported 318 million carcass-weight pounds of beef and veal products, compared to 153 million pounds during the same period in 2004.[3] Domestic beef demand increased by more than 7 percent in 2004 compared to 2003[4] but decreased 1.7 percent January through July 2005.[5]

The U.S. ban on importing cattle over 30 months of age, and beef from such cattle, from Canada remained in effect throughout FY 2005. Imports of Canadian cattle under 30 months of age were allowed beginning in July 2005. In January 2005, Tyson Foods, Inc., closed three of its steer and heifer slaughter plants for approximately 5 weeks and eliminated a shift in another plant. Also in January, National Beef Packing Company, LLC, announced a 20-percent reduction in production, and in August 2005, announced that it would discontinue Saturday slaughter of steers and heifers at two plants. In August 2005, Smithfield Foods, Inc., closed its Packerland Packing Company's Gering, Nebraska, cow slaughter plant; and Swift and Company closed its Nampa, Idaho, cow slaughter plant. Supplies of feeder cattle in the U.S. outside feedlots remained near the lowest level in many years as producers continued to retain heifers to build herds. Canadian cattle less than 30 months of age began to enter the U.S. soon after the ban on importing cattle and beef from Canada was lifted in July 2005. By September 2005, markets were beginning to adjust to imbalances in cattle numbers, slaughter capacities, and price differences between the two countries.[6]

From January through March 2005, the average cash feeder steer price at Oklahoma City was $104 per cwt compared to $112 per cwt during the same period in 2004 and $97 per cwt during the same period in 2003.[7] By September 2005, nearby feeder cattle futures prices increased to $115 per cwt.[8] Prices for the five-area weighted average direct slaughter steer price averaged $86 per cwt from October through December of 2004, averaged $90 per cwt from January through April 2005, and fell to $83 per cwt from May to August 2005.[9] As of August 2005, however, many cattle coming out of feedlots would have required prices in the $90-plus range to break even.[10] Grain prices remained favorable, but feeder cattle prices continued to be sufficiently high to take most of the profit potential out of feeding cattle.[11] High fed cattle prices, reduced supplies of slaughter cows, and increased slaughter capacity in Canada made it difficult for U.S. beef packers to maintain positive slaughter margins in 2005. From January to July 2005, 18.6 million head of commercial cattle were slaughtered in the U.S., down 3 percent from the same period in 2004.[12]

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[2] USDA, APHIS, *BSE Trade Ban Status as of 08/04/05,* http://www.aphis.usda.gov/lpa/issues/bse/trade/bse_trade_ban_status.html, accessed September 13, 2005.
[3] USDA, ERS, FATUS, *Monthly U.S. Livestock and Meat Trade,* http://www.ers.usda.gov/Briefing/Cattle/Data/MonthlyLivestockTable.xls, accessed September 9, 2005.
[4] Kansas State University Research and Extension, "*Beef Demand Strengthened in 2004, But Likely to Slow This Year,*" March 4, 2005, http:/www.oznet.ksu.edu/news/sty/2005/beef_demand030405.htm, accessed September 12, 2005.
[5] Glen Grimes and Ron Plain, University of Missouri – Columbia, "*Grimes & Plain Cattle Outlook*," September 9, 2005.
[6] USDA, ERS, *Livestock, Dairy, and Poultry Outlook,* LDP-M-134 August 18, 2005.
[7] USDA, ERS, *Livestock, Dairy, and Poultry Outlook,* LDP-M-134 August 18, 2005 and USDA, NASS, *Agricultural Prices 2004 Summary*, July 2005, [Pr 1-3 (05) a].
[8] Chicago Mercantile Exchange, *Delayed Futures and Option Quotes, Feeder Cattle Futures*, http://www.cme.com/trading/dta/del/delayed_quote.html?ProductSymbol=FC&ProductFoiType=FUT&ProductVenue=R&ProductType=com, accessed September 12, 2005.
[9] USDA, AMS, Market News, *5 Area Weekly Weighted Average Direct Slaughter Cattle*, LM_CT150. The five areas are Texas/Oklahoma/New Mexico, Nebraska, Kansas, Colorado, and Iowa/Minnesota.
[10] USDA, ERS, *Livestock, Dairy, and Poultry Outlook,* LDP-M-134 August 18, 2005.
[11] Ibid.
[12] USDA, NASS, *Livestock Slaughter*, August 19, 2005, Mt An 1-2 (8-05).

Acquisition and Concentration

In October 2004, Smithfield Foods, Inc., acquired the four cattle feedlots of MF Cattle Feeding, Inc., from ConAgra Foods, Inc. In April 2005, Cargill Meat Solutions, Inc., announced that it would purchase Better Beef Limited of Ontario, Canada, combining operations of the largest beef packing plant in Western Canada (Cargill Meat Solutions, Inc.) with the largest beef packing plant in Eastern Canada (Better Beef Limited). In May 2005, ContiGroup Companies, Inc., and Smithfield Foods, Inc., announced the completion of a joint venture between respective cattle feeding businesses, ContiBeef LLC and MF Cattle Feeding, Inc., called Five Rivers Ranch Cattle Feeding LLC, creating the world's largest cattle feeding operation. In August 2005, Rosen Meat Group, Inc., a subsidiary of Rosen's Diversified, Inc., merged with American Foods Group, Inc., creating American Foods Group, LLC, the Nation's largest cow and bull slaughtering company.

Concentration of the top four-firm steer and heifer slaughterers increased from 1980 to 1995; however, over the last several years it has remained stable, fluctuating between 79.2 and 81.4 percent (Table 1). Concentration declined slightly to 79.6 percent in 2004 from 80.2 percent in 2003. The U.S. Department of Justice and the Federal Trade Commission consider markets with Herfindahl-Hirschman Index (HHI) values below 1,000 to be unconcentrated, and markets with HHI values over 1,800 to be highly concentrated.[13] The HHI value in 1995, for all reporting packers, was 2,036; the value declined to 1,900 in 2003, the most current information available (Table 1).

Table 1.—Concentration of the top four-firm steer and heifer slaughterers and HHI for all reporting packers[1]

	1980	1985	1990	1995	2000	2002	2003	2004
Four-firm Concentration (percent)[2]	35.7	50.2	71.6	80.8	81.4	79.2	80.2	79.6
HHI[3]	561	999	1,661	2,036	1,939	1,842	1,900	NA

[1] Data for 1980, 1985, and 1990 are based on firms' fiscal years as reported to P&SP. Data for 1995–2004 are based on calendar year for federally inspected slaughter.
[2] Percentage of total commercial slaughter accounted for by the four largest firms.
[3] HHI (Herfindahl-Hirschman Index) equals the sum of each firm's squared percentage share of total commercial slaughter.

Marketing Methods

There are multiple marketing methods of live cattle that are available to producers. The methods commonly fall into two categories, cash sales and marketing agreements which create an assured procurement (often referred to "captive supply") and commit the cattle to a particular packer. Cash sales can be for immediate delivery or sometimes on a delayed delivery normally within a 2-week period.

Sales that are committed to a particular packer for delivery in excess of 14 days assure procurement for that packer. These arrangements can be written or oral and establish an ongoing relationship for trading multiple lots of fed cattle, rather than negotiating single lots of cattle.[14] "Forward contracts" refer to agreements between packers and sellers for future delivery of a specific lot or quantity of livestock. The price of these cattle can be set at the time of the contract or determined upon delivery based upon an agreed

[13] "Mergers producing an increase in the HHI of less than 50 points, even in highly concentrated markets post-merger, are unlikely to have adverse competitive consequences and ordinarily require no further analysis. Mergers producing an increase in the HHI of more than 50 points in highly concentrated markets post-merger potentially raise significant competitive concerns, depending on the factors set forth in Sections 2-5 of the Guidelines." U.S Department of Justice and the Federal Trade Commission, *Horizontal Merger Guidelines*, http://www.usdoj.gov/atr/public/guidelines/horiz_book/15.html, April 2, 1992 (as amended April 8, 1997).
[14] The term "lot" is commonly used by industry participants to represent a group of cattle purchased as a unit in a transaction.

pricing arrangement using prices from the Chicago Mercantile Exchange futures market for live cattle with an adjustment for the basis at the time of delivery. Formula pricing agreements vary depending upon the type of cattle involved and the desired retail product. In these arrangements the seller agrees to deliver cattle to the packer at a future date with the price being determined by carcass grade and/or yield. The pricing mechanism is normally based on the current cash market at the time of the arrangement with premiums or discounts calculated from the carcass evaluation. There are numerous of these arrangements in the current market, many of which are livestock committed to an alliance or cooperative of some type.

Some packers directly own and feed some of the cattle they slaughter. P&SP defines "packer fed" livestock as all livestock obtained for slaughter that a packer, a subsidiary of the packer, the packer's parent firm, or a subsidiary of the packer's parent owns, in whole or part, for more than 14 days before the packer slaughters the livestock.

In 2003, 38.5 percent of the four largest steer and heifer packers' slaughter was procured through captive supply, with 23.7 percent acquired through marketing agreements, 4.3 percent through forward contracts, and 10.4 percent packer fed (Table 2).

Table 2. Packer feeding, forward contracts, and marketing agreements as a percentage of steer and heifer slaughter, four largest steer and heifer packers, 2000 – 2003

Year[1]	Packer fed and other[2]	Forward Contracts	Marketing Agreements	Total
2000	9.1	2.0	27.1	38.2
2001	10.9	2.5	29.5	43.0
2002	9.6	2.4	32.4	44.4
2003	10.4	4.3	23.7	38.5

[1] Data for 2000 to 2003 were audited by GIPSA, and are not comparable to prior years (GIPSA-SR-05-1).
[2] "Other" includes steers and heifers purchased more than 14 days in advance of slaughter and not listed as packer fed, forward contracts, or marketing agreements.

Changing Business Practices in the Cattle Industry

Changing Business Practices as a Result of BSE

BSE concerns continued to affect livestock markets and slaughtering packers. Some packers ceased slaughtering non-ambulatory livestock and some re-tooled kill floors to slaughter fed cattle or species other than cattle. Cow and fed beef slaughterers, particularly in the northern U.S., reduced kills or closed plants. Livestock markets experienced a reduction in the number of cows and bulls consigned. Some markets reported a reduction in the number of sales held. Markets continue to reject distressed livestock.

Companies that produce, process, or market natural beef are growing in significance due to customer demand for meat products perceived to be healthier. Natural beef companies are using concerns about BSE and other pathogens as an affirmative marketing tool. Packing companies that process and market natural beef require confirmation from producers that livestock have not been fed specified feed additives, and that they market their product accordingly. P&SP found that one packer that processes natural beef has agreements with sellers to delay payment until it receives an affidavit from the livestock owner establishing the lack of antibiotics, hormones, and prohibited feed additives.

Animal Identification

Livestock identification has been utilized for years for various reasons, including: establishing ownership, vaccination information, and tracing purposes. Since the discovery in the United States of BSE and other serious animal diseases, animal identification has received more attention throughout the industry. The National Animal Identification System (NAIS) administered by APHIS, USDA, is a national program to provide uniform animal identification in the industry. Several States and livestock organizations are working on pilot identification programs. The goal of NAIS is to allow tracking of animals from point of origin to processing within 48 hours without unnecessary burden to producers and other stakeholders. It will use three identifying factors: (1) premises identification, i.e., identification of all locations that manage or hold animals, (2) animal registration, and (3) animal tracking.

The overall program is supported by the industry; however, the industry is split as to whether the program should be mandatory or voluntary. Currently, many segments of the cattle industry support making parts of the system mandatory over time.[15] At the end of January 2006, APHIS reported that 50 States, 5 Tribes, and 2 Territories had programs for registering premises that house animals, including locations where livestock and poultry are managed, marketed, or exhibited. APHIS also reported that over 196,000 premises were registered.[16]

Electronic Evaluation Devices

Packers are testing or using electronic evaluation devices to determine quality or yield grade factors. All four major packers have an electronic evaluation device in at least one plant.

AMS currently has performance standards established that provide for use of advanced technology to predict the yield grade characteristic for ribeye size or to predict the final yield grade of beef carcasses in accordance with the official *United States Standards for Grades of Beef Carcasses (January 31, 1997)*. USDA currently approves the protocol in three separate phases:

Phase I – Demonstrate accuracy and repeatability of prediction on stationary exhibits
Phase II – Demonstrate accuracy of prediction at line speeds
Phase III – Document operational procedures to ensure that appropriate presentation of carcasses and image capture are performed.

Currently, two technology providers are approved through Phase II. The requirements for Phase III are currently being modified, but are anticipated to be published soon. A packer representative from one of the big four packers has indicated that the electronic ribeye measurement will initially be used to pay premiums and discounts based on the size of the ribeye. P&SP recently witnessed the use of two electronic devices using digital camera images. One is stationary and analyzes carcass merit as the carcass passes through the unit. The other is physically placed over the ribeye by a plant employee as the carcass passes by on the grading chain.

In 2005, the National Conference on Weights and Measures (NCWM) adopted the American Society for Testing and Materials (ASTM) standards for electronic evaluation devices as a Tentative Code in its Handbook 44. The newly adopted standards cover equipment design resolution, units of measurement, and operator error; device performance repeatability, audit, examination, and tolerances; user requirements such as operation, installation, maintenance, training, and calibration; and predictive accuracy including repeatability, audit and examination. Inclusion of the standards in Handbook 44 promotes uniform application of the standards and enforcement by State officials.

Check Clearing for the 21st Century Act (Check 21)

Check 21 was signed into law in October 2003 and became effective in October 2004. Check 21 allows banks to truncate the flow of checks by creating substitute checks, to process information electronically and

[15] USDA, APHIS, National Animal Identification System (Draft) Strategic Plan - April 25, 2005.
[16] USDA, APHIS, *About NAIS*, http://animalid.aphis.usda.gov/nais/about/index.shtml, accessed February 8, 2006.

to deliver substitute checks to banks requiring a paper check. Uncollected checks or commercial paper in process of transfer from one bank to another bank result in a "float time" before the money transfer takes effect.[17] Check 21 facilitates the speedy payment of checks, resulting in less float time within the banking system.

Some livestock entities, especially auction markets, have relied on account floats to minimize the need to deposit actual funds into operating or custodial accounts. Check 21 increases the need for livestock entities to promptly deposit adequate funds to cover their payment responsibilities under the P&S Act.

Under the P&S Act, markets are required, before the close of the next business day following the sale of livestock, to remit net proceeds of the sale to consignors or shippers. Typically, markets have remitted proceeds the day of the sale to all consignors or shippers present at the sale and prepare checks for mailing to other consignors or shippers. Some consignors, especially at small markets or at small animal markets, have taken their checks directly to the bank for immediate payment on sale day. P&SP employees are finding that some payment procedures are changing. Some auction markets are remitting proceeds the day after the sale. This practice fulfills the markets' responsibilities under the P&S Act, but allows the markets 1 extra day to collect proceeds from the sale before consignor's checks can be presented to a bank. Some markets require buyers to wiretransfer payments or to use overnight mail (at the buyer's expense), and some markets are charging buyers a late fee for payment extending beyond 2 days. Check 21 will continue to change business practices as check processing times decrease and banks make changes in systems to facilitate the handling of checks.

[17] The Federal Reserve Board, *"Check Clearing for the 21st Century Act,"* http://www.federalreserve.gov/paymentsystems/truncation/default.htm, accessed October 13, 2005.

Section 2: Hog Industry

General Economic State of the Hog Industry

For most of the past fiscal year the hog industry benefited from high hog prices, strong domestic and export demand, and low feed prices. In May 2005, signs of weakening domestic demand became apparent, and producers' prices began to decline. From October 2004 to April 2005, the 51-52 percent lean equivalent base price average was $71.39 per cwt[18], an increase of 27 percent over the previous year. The market peaked in December 2004, reaching a high of $81.87. While prices remained higher than the previous year for each month through April 2005, the general trend was downward. In May and June 2005, prices fell to an average of $71.12, a decline of nearly 10 percent from the same period in 2004. Retail pork prices remained high and relatively constant from October 2004 through June 2005, with per pound prices in the $2.80s.[19] Wholesale cutout prices saw slow but relatively steady declines, with second quarter 2005 prices down about 3 percent from the previous year.[20] From January through June 2005, demand for live hogs was up 1.6 percent, while demand for pork was down 3 percent from the previous year.[21] High retail pork prices, high energy prices, declining beef prices, increased poultry production, and lessening popularity of high-protein diets affected pork demand.[22] Despite lower prices in the latter part of the period, estimated returns to producers were still positive for the first half of 2005.[23] Packer margins throughout most of the year were low to negative.

Exports continued to increase throughout the year, as the industry held historical markets and expanded into newer markets. In the second quarter of 2005, exports rose 28 percent over the year before.[24] U.S. pork exports exceeded more than 2.6 billion pounds in 2005, an increase of 21 percent over 2004.[25] The primary markets for U.S. pork were Japan (accounting for 41 percent of U.S. pork exports from January through June 2005), Mexico (19 percent) and Canada (11 percent).[26] Exports to Russia more than doubled in the first 6 months of calendar year 2005 compared to the same period in 2004, and exports to smaller markets such as South Korea, Romania, and Australia also grew rapidly.[27] U.S. pork exports have set progressively higher record levels since 2003, and now represent 15 percent of production, up from 8 percent in 2002.[28] Various factors account for the upsurge in pork exports over the past few years, including: a weaker dollar, making U.S. exports more affordable in foreign markets; BSE-related import bans on U.S. beef; rising standards of living in other countries; and concerns about livestock and poultry diseases in importing countries.[29] Pork imports from January to June 2005 declined 9.3 percent compared to the same period in 2004, primarily due to the weaker dollar.[30]

In spite of record hog prices during the past 2 years, producers restrained herd expansion. The total number of hogs was estimated at 60.8 million head in June 2005, up 0.2 percent from the previous year. Market hogs totaled 54.8 million head (up 0.1 percent from 2004) while the number of breeding hogs was 6 million head (up 0.7 percent).[31] While the hog herd size growth was restrained, USDA analysts estimate that pork

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[18] USDA, AMS, *Iowa/Minnesota Daily Direct Hogs Report*, LM_HG204, Various Issues.
[19] USDA, ERS, *Livestock, Dairy and Poultry Outlook*, Various Issues, 2004 and 2005.
[20] USDA, AMS, *Iowa/Minnesota Daily Direct Hogs Report*, LM_HG204, Various Issues.
[21] Glenn Grimes, *University of Missouri Demand Index*, http://agebb.missouri.edu/mkt/bull13c.htm, accessed October 13, 2005.
[22] Glenn Grimes and Ron Plain, *University of Missouri Hog Outlook*, http://agebb.missouri.edu/mkt/bull1c.htm, accessed August 19, 2005; USDA, ERS, *Livestock, Dairy and Poultry Outlook*, June 16, 2005; Ron Plain, University of Missouri Swine Economics Report, http://agebb.missouri.edu/mkt/bull1b.htm, accessed July 18, 2005.
[23] USDA, NASS, *Quarterly Hogs and Pigs Report*, June 2005.
[24] USDA, ERS, *Livestock, Dairy and Poultry Outlook*, August 18, 2005.
[25] USDA, ERS, *Livestock, Dairy and Poultry Outlook*, July 18, 2005.
[26] Ibid.
[27] Steve Meyer and Len Steiner, *Daily Livestock Report*, Volume 3, Issue 155, August 16, 2005; USDA-ERS, *Livestock, Dairy and Poultry Outlook*, various issues, 2005.
[28] USDA, ERS, *Livestock, Dairy and Poultry Outlook*, June 16, 2005.
[29] USDA, ERS, *Livestock, Dairy and Poultry Outlook*, May 19, 2005.
[30] Ron Plain, *University of Missouri Swine Economics Report*, http://agebb.missouri.edu/mkt/bull1b.htm, accessed August 18, 2005.
[31] USDA, NASS, *Quarterly Hogs and Pigs Report*, March 2005 and June 2005.

production for 2005 will be 20.7 billion pounds, up 0.8 percent from 2004.[32] There are several reasons for the growth in production. Low feed costs and high hog prices offer producers an incentive to produce heavier hogs. Accordingly, the average dressed weight of hogs ranged from 201 to 203 pounds during the first 6 months of 2005, about 2 pounds more than the same period in 2004.[33] Environmental regulations, local permitting requirements, and capital barriers to expansion also provided an incentive to increase slaughter weight instead of number of hogs.[34] As a result of advances in breeding herd productivity, a continuing increase in the number of pigs per litter has became an important means of expanding pork production without adding to herd numbers. For example, pigs per litter averaged 9.02 in June through August of 2005, compared to 9.01 and 8.90 in the same periods in 2004 and 2003, respectively.[35] Imported live animals from Canada slaughtered in the U.S. also added to total production of pork in the U.S.

Acquisition and Concentration

In December 2004, Hormel Foods purchased Clougherty Packing Co., a privately held California pork packing company, for $186 million. Based on U.S. Department of Justice guidelines[36], this acquisition did not significantly increase concentration in the pork packing industry. Table 3 shows that the four-firm concentration ratio remained constant at 64 percent between 2003 and 2004, after the Hormel-Clougherty merger. In the previous year, the acquisition of Farmland Foods by Smithfield Foods, Inc., caused the concentration ratio to rise from 55 to 64 percent, and the HHI to increase from 1,005 to 1,334.[37] In another important merger, in May 2005 Seaboard Farms (later renamed Seaboard Foods) announced plans to purchase Daily's, a bacon processor in Utah and Montana.

Table 3.—Concentration of the top four hog slaughter firms and HHI for all reporting packers[1]

	1985	1990	1995	2000	2001	2002	2003	2004
Four-firm Concentration (percent)[2]	32.2	40.3	45.7	56.4	56.7	55.4	64.2	64.1
HHI[3]	456	593	769	1,033	1,035	1,005	1,334	NA

[1] Data for 1980, 1985, and 1990 are based on firms' fiscal years as reported to P&SP. Data for 1995–2004 are based on calendar year for federally inspected slaughter.
[2] Percentage of total commercial slaughter accounted for by the four largest firms.
[3] HHI (Herfindahl-Hirschman Index) equals the sum of each firm's squared percentage share of total commercial slaughter.

Changing Business Practices in the Hog Industry

Swine Marketing Contracts

Swine marketing contracts between producers and packers became a major factor in the pork industry during the 1990s. In 2005, many contracts came up for renewal and pork producers considered their marketing options for the future. With market contracts, packers and livestock producers set a price based on pre-determined formulas and factors usually involving a spot market or key production costs. In 2005, some hog packers elected to renew or offer new contracts using estimated pork cut-out prices reported by AMS, USDA, as a means to set base price. These reported prices do not reflect data gleaned from mandatory price reporting requirements.

[32] USDA, OCE, World Agricultural Supply and Demand Estimates, January 12, 2006.
[33] USDA, ERS, *Livestock, Dairy and Poultry Outlook*, June 16, 2005.
[34] USDA, ERS, *Livestock, Dairy and Poultry Outlook*, January 21, 2005.
[35] USDA, NASS, *Quarterly Hogs and Pigs,* September 30, 2005.
[36] U.S. Department of Justice, *Horizontal Merger Guidelines*, April 2, 1992 (revised April 8, 1997).
[37] USDA, GIPSA, *Packers and Stockyards Statistical Report: 2003 Reporting Year*, June 2005.

Carcass Evaluation Device Standards

Packers continue to move toward use of electronic evaluation devices to measure the carcass characteristics of interest, and producers rely on the packer to maintain and operate the electronic carcass evaluation devices fairly and accurately. Producers, however, do not have the ability to monitor packers' use of the technology, although third-party oversight may be implemented in the future.

In 2005, the National Conference on Weights and Measures (NCWM) adopted the American Society for Testing and Materials (ASTM) standards for electronic evaluation devices as a Tentative Code in its Handbook 44. The newly adopted standards cover equipment design resolution, units of measurement, and operator error; and device performance repeatability, audit, examination, and tolerances. The standards also cover user requirements such as operation, installation, maintenance, training, and calibration; and predictive accuracy including repeatability, audit and examination. Inclusion of the standards in Handbook 44 promotes uniform application of the standards and enforcement by State officials.

Trend Towards Deeper Discounts on Heavy Hogs

In 2005, information obtained by P&SP from packers, including payment grids on contracts filed to the GIPSA's Swine Contract Library, indicated that packer margins for heavy hogs appeared to decline as some packers adjusted sort loss discounts. These adjustments provided a clear price signal to hog producers by offering less incentive to produce hogs that did not meet desired weight specifications. The adjustments to the schedules of premiums and discounts meant that hog producers are being required to carefully sort hogs to meet packers' desired weight specifications in order to optimize payment.

Section 3: Poultry Industry

General Economic State of the Poultry Industry

Despite an increase in production in FY 2005, the combination of strong domestic demand and an increase in exports limited downward pressure on broiler prices. U.S. broiler prices were moderately lower from February through September 2005, compared to the same period in 2004. The wholesale price in 12 major metropolitan areas averaged 72.6 cents per pound in the first 6 months of 2005 compared to 76.3 cents in the first half of 2004, and 59.9 cents in the first half of 2003.[38] Federally inspected broiler slaughter (pounds) was 4.9 percent higher in the first 6 months of 2005, compared to the same period in 2004.[39]

Turkey prices in the U.S. moved higher in the first 6 months of 2005 compared to the same period in 2004. Turkey hen prices (8-16 pounds) in the Eastern U.S. during the first and second quarters of 2005 were 6.1 percent and 1.7 percent higher, respectively, than in the same periods in 2004.[40] Federally inspected turkey slaughter (pounds) increased 1.4 percent in the first half of 2005 compared to the same period in 2004.[41] Increased exports of turkey from the U.S. in the first 6 months of 2005 resulted in falling turkey cold storage stocks despite the higher production and slightly lower domestic consumption.

Acquisitions and Concentration

There were no major acquisitions or mergers by broiler slaughterers in FY 2005. The four-firm concentration ratio in broiler slaughter rose from 48 percent in the years 2001 and 2002 to 55 percent in 2003, and dropped 1 percentage point to 54 percent in 2004, which is the most current data available (Table 4). The HHI for the broiler industry fell slightly from 995 in 2003 to 974 in 2004.

Table 4.—Concentration of the top four-firm broiler slaughterers and HHI for all reporting packers[1]

	1990	1995	1997	2000	2001	2002	2003	2004
Four-firm Concentration (percent)[2]	41	46	44	49	48	48	55	54
HHI	NA	NA	611	916	876	868	995	974

[1] Based on pounds of ready-to-cook production reported in Watt Poultry USA Rankings, various years.
[2] Percent of total commercial slaughter accounted for by the four largest firms.

Although there were no major acquisitions or mergers, one firm expanded operations and one firm changed ownership in FY 2005. Sanderson Farms, Inc., began operations at its newly constructed broiler slaughter complex facilities in Moultrie, Georgia, in August 2005. In August 2005, The Hain Celestial Group, a Melville, New York, based natural and organic food and personal care products company, purchased the poultry processing facility assets of Fredericksburg, Pennsylvania, based College Hill Poultry.

No significant expansions, consolidations, mergers, or acquisitions occurred in the turkey industry during FY 2005. The turkey slaughter concentration ratios rose from 54 percent in 2002 and 2003 to 55 percent in 2004, which is the most current data available (Table 5). The HHI for the turkey industry rose slightly from 911 in 2003 to 951 in 2004.

[38] Cattle Fax, "12 City Broiler (Monthly Price)" http://www.cattle-fax.com/data/files/poultry/12citybroilerprice.xls, accessed October 13, 2005.
[39] USDA, ERS, *Livestock, Dairy and Poultry Outlook.* LDP-M-135.
[40] Ibid.
[41] Ibid.

Table 5.—Concentration of the top four-firm turkey slaughterers and HHI for all reporting packers[1]

	1987	1992	1997	2000	2001	2002	2003	2004
Four-firm Concentration (percent)[2]	38	45	41	41	55	54	54	55
HHI	NA	NA	496	680	975	945	911	951

[1] Data for 1997 and after from Watt Poultry USA. "WATT Poultry USA Rankings," various years. Earlier data from Ollinger, M.; J. MacDonald; and M. Madison. 2000. "Structural Change in U.S. Chicken and Turkey Slaughter," Economic Research Service, USDA, Agricultural Economic Report No. 787, Washington, D.C.
[2] Percent of total commercial slaughter accounted for by the four largest firms.

Changing Business Practices in the Poultry Industry

Avian Influenza

Avian influenza is a highly contagious viral disease affecting mostly chickens, ducks, turkeys, quail, and other birds. Outbreaks of highly pathogenic avian influenza (HPAI) and H5N1 continued in Asia and spread to Eastern Europe in 2005. The spread of the disease in Asia and parts of Europe has been facilitated by production in outdoor conditions and the intermingling of poultry in live bird markets. The U.S. commercial poultry industry contrasts sharply to European and Asian markets in that birds are raised in confinement where they are insulated from infected birds in other flocks and wild birds. In addition, the U.S. commercial sector is made up of vertically integrated firms that own the bird from chick to slaughter, constantly monitor the health of flocks, and take biosecurity precautions. In response to recent concerns regarding avian influenza, a voluntary industry testing program operated in cooperation with the USDA is being dramatically expanded by all major poultry companies, covering 90 percent of U.S. flocks.

Increasing Broiler Weights

Changing consumer demands for ready-to-eat chicken products affect the way poultry processors produce and market broilers. Poultry processors are increasing the processing weight of broilers due to increasing consumer demand for new products and the desire to maximize efficiency in processing. Broiler weights in 2004 and 2005 have been significantly higher than the 5-year average. The mixture of smaller whole/foodservice birds versus larger boning/processing birds plays a major role in the overall average weight of broilers.[42]

Hurricanes Katrina and Rita Effects

In August 2005, Hurricane Katrina devastated portions of southern Louisiana and parts of southern and central Mississippi. USDA's Economic Research Service reports that the impact of Hurricane Katrina on overall U.S. broiler production is expected to be relatively small, although damage in specific areas was heavy.[43] There are approximately 9,000 poultry houses in Mississippi and more than 2,000 poultry farmers. An estimated 2,400 poultry houses in Mississippi sustained some damage and, of the damaged houses, approximately 300 were destroyed. A poultry house typically contains 20,000-25,000 birds during the growth cycle. Mississippi produces 10 percent of the country's poultry, and bird losses were in the millions. Poultry houses destroyed by Hurricane Katrina may be rebuilt, but with newer and more modern equipment.

[42] Chicago Mercantile Exchange, *"Daily Livestock Report,"* www.cme.com, accessed July 11, 2005.
[43] USDA, ERS, *Livestock, Dairy, and Poultry Outlook*, September 16, 2005.

Hurricane Katrina also damaged the port cities of New Orleans, Louisiana, and Gulfport, Mississippi. Port facilities along the Gulf of Mexico account for as much as three-quarters of the poultry exported from the United States to Russia. Poultry companies shifted export traffic from these damaged facilities to Pensacola, Florida; Mobile, Alabama; and other ports.[44]

Poultry Care and Handling

Animal welfare has become a priority issue in the poultry industry. Many poultry companies now hire personnel to oversee the proper care and handling of poultry through all points from the hatchery, to the grow-out operations on the farm, and to the processing plant. Most companies conduct internal audits specifically for the proper care and handling of poultry.[45]

Fast food customers, distribution companies, grocery chains, and foreign governments often require poultry companies to adopt the standards of care set by various animal welfare audit programs. The customers either conduct audits themselves or contract for external audits of the processing plants and the care and handling on independent broiler farms.[46]

[44] Poultry Times, *"Industry Affected By Hurricane Katrina,"* www.poultryandeggnews.com, accessed September 26, 2005.
[45] U.S. Poultry and Egg Association, Poultry Care and Handling Workshop, "*The NCC Animal Welfare Program: Guidelines and Audit Procedures,"* presented by Stephen Pretanik, August 10-11, 2005.
[46] U.S. Poultry and Egg Association, Poultry Care and Handling Workshop, "*SYSCO Corporation Poultry Animal Handling and Welfare Program,"* presented by Dale Schiffner, August 10-11, 2005.

Section 4: Operations or Activities in the Livestock and Poultry Industries that Raise Concerns under the Packers and Stockyards Act

Adequacy of Bonds for Regulated Entities

The regulations issued under the P&S Act prescribe bond requirements and bonding formulas for packers purchasing over $500,000 of livestock annually; market agencies buying or selling on commission, or acting as clearing agencies; and dealers. These entities must execute and maintain a bond or bond equivalent to protect livestock sellers. The regulation that establishes formulas for computing bond amounts was last modified in 1983. These bonding formulas do not always provide full coverage to livestock sellers when bonded entities fail financially. Between FY 2000 and FY 2003, sellers who were not paid as a result of financial failures by market agencies selling on commission recovered 31–47 percent of their total claim amounts each year. During the same period, the recovery rate was 15–28 percent for dealers and market agencies buying on commission that failed financially.

GIPSA Response: P&SP formed an internal task force to evaluate the effectiveness of P&SP's bond requirements in today's regulated industries. The task force's initial findings showed that the cost of increasing bond coverage at an equal rate for all dealers, market agencies and subject packers outweighed the benefits to livestock sellers. The task force continued exploring alternatives to across-the-board bond increases and developed additional recommendations. After a review and evaluation of the task force's revised recommendations, P&SP will initiate appropriate action.

Retaliation in the Poultry Industry

P&SP regularly hears from and meets with poultry growers and other members of the poultry industry. A recurring concern reported to P&SP during FY 2005 was retaliation by live poultry dealers against poultry growers who report unfair practices to USDA or other law enforcement agencies.

GIPSA Response: Retaliation by a live poultry dealer against a poultry grower for expressing concerns and filing complaints with appropriate law enforcement agencies, including USDA, is an unfair practice. P&SP will vigorously investigate reported incidences of retaliation and initiate action.

P&SP is considering modifying existing regulations to provide increased transparency in agreements between live poultry dealers and poultry growers. These modifications could include prescribing a minimum period of time for poultry growers to review poultry growing arrangements before entering into such agreements or requiring that additional information be provided by live poultry dealers to poultry growers in settlement documents.

Federal Litigation in the Poultry Industry

In June 2005, the U.S. Court of Appeals for the Eleventh Circuit held that a plaintiff alleging violations of Section 202 of the P&S Act by a live poultry dealer must prove that the alleged violation adversely affects competition or is likely to adversely affect competition in order to prevail. Section 202 prohibits live poultry dealers from engaging in or using "any unfair, unjustly discriminatory, or deceptive practice or device."

The plaintiffs in this case were poultry growers who grew poultry under production contracts with a live poultry dealer. The plaintiffs brought an action against the live poultry dealer alleging violations of the P&S Act, including unfair contract termination and retaliation. After a jury verdict in favor of the plaintiffs, the Federal district court set aside the verdict, including monetary damages, and the plaintiffs appealed.

USDA, through an *amicus curiae* brief, argued that "the plain language of the statute, the purpose of the P&S Act, and the . . . [Secretary's] interpretation all indicate that in order to prove that any practice is 'unfair' under § 202(a), it is not necessary to prove predatory intent, competitive injury, or likelihood of injury." The live poultry dealer argued that the district court correctly ruled that the plaintiffs must establish that "the unfair, discriminatory or deceptive practice adversely affected competition in order to prevail under the PSA."

The Eleventh Circuit Court held that violation of section 202(a) of the P&S Act must have a showing of competitive harm or the likelihood thereof.

GIPSA Response: GIPSA lacks administrative authority to enforce violations of section 202 of the P&S Act against live poultry dealers. Enforcement actions must be referred to the U.S. Department of Justice and are litigated in Federal district court. GIPSA is evaluating the Eleventh Circuit Court's decision and its impact on future cases involving alleged violations of section 202 by live poultry dealers.

Livestock, Meat, and Poultry Carcass Evaluation Devices and/or Systems

In the livestock and meatpacking industries, packers and producers are expanding beyond USDA grading to determine the value and payment for livestock purchased on a carcass merit basis. The industries are developing sophisticated electronic evaluation devices and/or systems to measure live or carcass merit quality characteristics upon which payment is based. Before 2003, there were no established, verifiable and traceable standards in use to determine the accuracy of electronic evaluation devices and/or systems.

In the hog industry, packers pay most producers based on the estimated lean percent of hogs, using formulas that incorporate measurements taken by electronic carcass evaluation devices. In the cattle industry, packers pay some producers on the yield grade of their cattle, estimated by electronic evaluation devices. In both industries, packers are replacing USDA graders (in whole or in part) with electronic carcass evaluation devices. Packers use the devices to measure the carcass characteristic of interest, and producers rely on the packer to maintain and operate the electronic carcass evaluation devices fairly and accurately. Producers, however, do not have the ability to monitor the packer's use of the technology, although third-party oversight may be possible.

GIPSA Response: Because there were no standards governing the use and accuracy of electronic evaluation devices in the livestock and meatpacking industries, P&SP established a task force, with assistance from the NIST, AMS, personnel from State weights and measures departments, equipment manufacturers, academicians, and others, to develop voluntary industry standards governing use of these electronic evaluation devices. Four voluntary standards were recently adopted and published by ASTM:

- **Design of Device**: Sets out certain criteria for the design of the evaluation devices (impacts manufacturers);
- **Device Performance**: Sets out criteria for the performance of the evaluation devices and systems (impacts manufacturers, meat packers, and live poultry dealers);
- **User Requirements**: Sets out requirements for users, including maintenance, operation, inspection, etc. (impacts meat packers and live poultry dealers); and
- **Predictive Accuracy**: Sets out standardized methods to collect and analyze data and develop a formula used to determine payment (impacts meat packers and live poultry dealers).

In July 2005, NCWM adopted the voluntary industry standards on carcass evaluation devices as a tentative code in the NIST Handbook 44. Inclusion of the standards in Handbook 44 promotes uniform application of the standards and enforcement by State officials.

OMB Control No. 0580-0015

U.S. DEPARTMENT OF AGRICULTURE GRAIN INSPECTION, PACKERS AND STOCKYARDS ADMINISTRATION PACKERS AND STOCKYARDS PROGRAMS	**ANNUAL ASSESSMENT REPORT COMMENT FORM**

Thank you for your interest in GIPSA's Report, *Assessment of the Cattle, Hog, Poultry, and Sheep Industries*. As a means of both improving the publication and gaining insight on the issues arising in the cattle, hog, poultry, and sheep industries, we invite your comments and ideas for future publications.

1. Please indicate which area of the report you found to be the <u>most</u> useful (please check one box):

❑ General Economic State ❑ Changing Business Practices ❑ Operations or Activities that Raise Concerns

2. Please indicate which area of the report you found to be the <u>least</u> useful (please check one box):

❑ General Economic State ❑ Changing Business Practices ❑ Operations or Activities that Raise Concerns

3. Please rate your overall satisfaction with the report (please check one box):

❑ Excellent ❑ Good ❑ Average ❑ Poor ❑ Very Poor

4. Please identify each industry you are involved with (please check all that apply):

❑ Cattle ❑ Hog ❑ Poultry ❑ Sheep ❑ Other: ____________

5. Please identify your primary role(s) in the industry:

❑ Producer ❑ Processor ❑ Packer ❑ Stockyard ❑ Feedlot ❑ Other: ____________

6. **What changing business practices have you witnessed in the livestock, poultry, or meat industry?**

____

____

7. **What concerns in your industry would you like us to address in future publications?**

____

____

8. Additional comments or suggestions:

____

____

9. If you would like to provide your contact information, please do so below.

Name: ____
Last Name First Name

Business Name (if applicable): ______________________________

Mailing Address: ____
Street

____
City/Town State Zip Code

E-mail Address: ____

Telephone Number: (including area code) ____________________________

Thank you for your response to this questionnaire.

Please submit the completed questionnaire using one of the following methods:

1) Mail the document to the following address:
   USDA,Grain Inspection Packers and Stockyards Administration
   Packers and Stockyards Programs, CMAR
   1400 Independence Ave. SW, Stop 3647
   Washington, DC 20250-3647
2) E-mail the form to: pspess@usda.gov with the subject line as "CMAR," or
3) Fax the form to: (202) 690-1266, ATTN: CMAR COORDINATOR.

According to the Paperwork reduction Act of 1995, no persons are required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information is 0580-0015. The time required to complete this collection is estimated to average 10 minutes per response, including the time to review instructions, search existing data resources, gather the data needed, and complete and review the information collection.

Instructions for Completing
the Annual Assessment Report Comment Form P&SP-6020

You may use any of the following methods to submit the form:

1) Mail the document to the following address:
   USDA Grain Inspection Packers and Stockyards Administration
   Packers and Stockyards Programs, CMAR
   1400 Independence Ave. SW, Stop 3647
   Washington, DC 20250-3647
2) E-mail the form to: pspess@usda.gov, with the subject line as "CMAR," or
3) Fax the form to: (202) 690-1266, ATTN: CMAR COORDINATOR.

Line No.	Subject	Instruction
1.	Most Useful Part of the Report	Check the appropriate box to indicate which part of the report you found most useful.
2.	Least Useful Part of the Report	Check the appropriate box to indicate which part of the report you found least useful.
3.	Overall Satisfaction	Check the appropriate box to indicate your overall opinion of the report.
4.	Industry Segment	Check the appropriate box(es) to indicate each livestock category you work with.
5.	Industry Roles	Check the appropriate box(es) to indicate your primary roles in the livestock, poultry, or meat industries.
6.	Changing Business Practices	Enter a description of the changing business practices that you noticed during the past year.
7.	Industry Concerns	Enter a description of the concerns you experienced in the livestock, poultry, or meat industries over the past year that you would like us to address in future publications.
8.	Additional Comments	Enter any additional comments that will help to improve future annual assessment reports.
9.	Contact Information	Enter your name, business name, mailing address, e-mail address, and telephone number.